# THE OBSTACLES TO CURRENCY REFORM

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The first evidence that a financial crisis had arisen in the late months of 1907, was found in the banking situation in New York City. The conditions necessary to produce it had evolved slowly. These conditions were an increasing expansion of bank credits, payable on demand, given in exchange for obligations, whether payable by *their* terms on demand, or at a future date, secured as to *payment* by certificates of stock ownership in some corporation, or by debt obligations, redeemable by their terms at some distant period of time. There then was, and long had been, an accepted theory that good investment securities dealt in on the New York Stock Exchange were at any time convertible into cash through a sale in the open market. One of the "lessons" learned is that the theory stated is true to a comparatively narrow degree and, put to a serious test, it utterly breaks down. We have learned that where all become "would-be" sellers, there is no power to buy. We have learned in a new and impressive way that expanding prices, stimulated by expanding credits, will at last lead to a crisis which must be faced.

Such a crisis was reached in the early autumn months of 1907. It was precipitated by calls from the interior for money to "move the crops." Response to these calls weakened the foundation of cash reserve, in the New York banks, to which the great superstructure of bank loans and bank "deposits" stood logically related. Something similar has been witnessed at each recurring harvest season for years past, and in truth it may be said, that in our system of banking and currency, a financial crisis is an annual visitation. Reference to the tabulated movements in loans, deposits and the cash reserve, sufficiently prove it to be so. But did not the crisis of 1907 differ from the crises of recent years? Yes, but rather in the intensity, than in the nature of it. The crisis, with all its necessary incidents of loss and distress, might have been met and overcome as have the yearly recurring crisis to which reference has

been made, except for certain aggravating accessories of fake banking and reckless administration brought suddenly into the light of publicity by the exactions of the occasion.

The situation of the Knickerbocker Trust Company and some institutions similar to it changed the condition of things. What would, rightly named, have been a grave crisis became something else, something more fierce, dangerous and destructive. The crisis was metamorphosed into a wild, unreasoning and destructive panic. There is always danger of such an eventuation in every period of crisis, or general financial strain, and our experience goes to show that our financial system offers little or no hindrance to the degenerative process which begins in crisis and ends in panic.

As with other peoples, a crisis is not an unfamiliar experience. Our marked inferiority is shown in the method and machinery which we employ to readjust the conditions which have become acute and threatening. It may be profitable to compare our financial machinery with that of France, as indicated by familiar history.

In 1870-71 France was in a state bordering on complete anarchy. She had fought an exhausting but futile war. She witnessed the triumphant march of the enemy's victorious army through the streets of her capital. She was under duress to pay a thousand millions of dollars of war indemnity to her conqueror. She was obliged to suffer the rise of the Commune—with its régime of riot, arson, bloodshed and ruin. Under circumstances like these, industry of course, suffered, trade and commerce were deeply afflicted, but through all the trying period these were steadied and supported by the continued operations of that great institution, the Bank of France. True, under the exigencies of events—and in the interest of prudence the bank suspended for a time specie payment upon its outstanding note issues, then amounting to some five hundred millions of dollars. These notes, it must be remembered, were not secured by the pledge of security in the hands of independent trustees. They were what must be denominated credit notes, or, if you prefer a name more opprobrious, they were an "asset currency." Nevertheless, by their use the bank continued to discharge its true and proper function with a minimum of interruption and derangement, and at no time in all that trying period did gold command a premium so high, measured by the notes of the Bank of France, as did ordinary paper money command with

us, measured by clearing-house checks, at a period of profound peace at the culmination of a year of unexampled prosperity, hereafter to be known as "The Panic Year 1907."

We had no Bank of France nor anything analogous to it. We had, instead, some 6,500 national banks, besides numberless other similar institutions, all of which, with a few remarkable exceptions, suddenly ceased to perform their functions as intermediaries in the exchanges and as lenders of money or credit. The quick consequences,—trade interruption, individual and corporate bankruptcies, the relegation of labor to distressful idleness, are too near and too familiar to our knowledge to need description. We have, I believe, received another painful lesson from which we may rightly gather that our banking and currency system must be put on new and better foundations. I shall not take space to mark out a "plan" for such a system. It may be allowed me here to point out some of the obstacles which must be met and removed as a necessary part of any adequate reform.

These obstacles consist of certain financial artificialities in government finances which, while they exist, make a return to principles dictated by economic law nearly or quite impossible. These artificialities menace the financial strength of the government and embarrass the true path to a wise and adequate system of banking and currency. What are some of these artificialities? When and how were they born? To answer the last question first, they were developed chiefly as a result of the necessities of the government in the Civil War. Of what do they consist? I name them briefly.

(1) The legal tender note—greenback. If it were necessary to issue them in the beginning they should long ago have been retired. They were a device born of a temporary need. They were false to the economic requirements of a true currency. Legally equal to gold as a cash reserve, we witness the anomaly of a debt obligation issued by the government made the legal basis for debt obligations issued by banks, to an amount four times as great. They thus weaken the foundation of metallic money—on which the fabric of our whole credit system must finally rest. It is perceived that non-interest notes payable on demand are an immediate economy over time obligations charged with interest, and this benefit the people refuse to surrender.

(2) The system of national bank notes was also a device to create an artificial market for United States bonds. Their issue and use bear no relation to the true law which should govern in the field where paper money performs its true function. The result is seen in two directions. In the first place it has artificialized the price of government bonds to an extent of at least 20 per cent, measured by the world's standard of value as found in a free and open market, where similar securities are bought and sold. As an incident to this artificialism, the government has become the guarantor of payment for some seven hundred millions of notes issued by more than 6,500 so-called national banks. That is a false relationship. It ought not to continue.

(3) By the drift of events, and through political pressure, there has been injected into the channels of our circulation some six hundred millions of silver now possessed of a natural commercial value, measured by gold, of about three hundred millions, but maintained at parity with gold through the government's pledge to maintain such a parity.

Looked at from the government's side, we have here a direct or contingent liability consisting of United States notes, $346,000,000, silver currency parity, $300,000,000, national bank notes, $700,000,000. This liability is not at all embarrassing to the government at the moment and is not likely to become so, provided we can continuously avert foreign or domestic war, and provided further, that the channels of trade where money circulates, can be to a large degree monopolized by the greenbacks and by silver or silver certificates. It is not germane to this discussion to consider the financial embarrassment which would face the government by reason of its artificial relation to money and currency, in the event of a costly and expensive war. I cannot, however, forbear to invite consideration to what is now everywhere recognized; viz., that a strong military chest and an unimpeachable credit, are as essential to success in war as are armies and navies. To the support of these latter we devote an approximate hundred millions each per annum, but for the sake of economizing a few millions we neglect to fortify our *financial* defense, we drift along in a position which must be confessed as weak if not inexcusable. It is, however, to the reflex effect upon our general industrial affairs that my thought must be directed. I have said that the path to

more perfect conditions in banking and currency is blocked by the artificialities developed by our financial legislation.

There would be no proper cause for complaint in this if it were true, as to many minds it seems to be true that the banking function, with its currency features, is a sort of privilege granted by the grace of government to certain favored groups who are thus permitted to exploit the people for their own exclusive aggrandizement. If such a view were the correct one, then the more of obstacles, restrictions and repression the better. But when a correct understanding takes the place of these misapprehensions, then it will be perceived that what hinders, restricts or prevents the just economic exercise of the banking function, interferes to embarass an agency which next below production and transportation ministers most directly to the industrial life wherein our material prosperity must be found.

In every other relationship, existing between men, there is a true law which, if discovered and obeyed, will bring in peace and happiness. So, in the field of banking and currency, there are principles which, recognized and adopted as the rule of action, must bring in as a resultant the highest benefits to all. Our history for the last forty years suggests in the most emphatic way that our banking and currency system has at some points been out of harmony with the true laws which should govern it. Unhappily, too, it is evident enough that if this be true the general apprehension of the fact is not at present wide enough or deep enough to induce the study of first principles, much less to give them the right of way, even if cherished prejudices, or apparent temporary advantages must needs be sacrificed.

Is it then possible for us to recast out statute laws so as to forestall in the future, the shameful situation in which our commercial and industrial interests now find themselves, as a consequence of the sudden, yet necessary cessation of proper functioning by the banking system, which we have been silly enough to call "the best on earth?" Yes, undoubtedly, provided we are able to recognize that principles are superior to make-shift policies. Patch-work legislation will not accomplish it. Invention, however ingenious, will only flatter, deceive and betray us. Only by complete recognition of and conformity to economic law, now fairly well understood by the thoughtful and experienced student—applied and tested as

it has been by older and more experienced nations—can the humiliating and costly lesson, furnished by the late "crisis" be made to bear fruit for the healing of the nation.

Impressed by the lesson to be drawn from the late crisis, our Senators and Representatives in Congress assembled, are engaged, to some extent, in considering by what measures the future can be guarded from the disasters which have overtaken us in the past and present time. Two bills of especial prominence are offered for approval. One is known as the Aldrich Bill, offered in the Senate; the other is known as the Fowler Bill, offered in the House. The first named seeks to bring relief to a financial crisis by providing an artificial method through which currency may be issued by the banks in a time of extraordinary pressure. It is a make-shift invention, operating to supplement other artificialities, the existence and continuation of which have been and will be disturbing, unsettling factors in the department of our credit machinery, the right working of which is hardly second in importance to continuous production and uninterrupted facilities for transportation. The Fowler Bill, in marked contrast, betrays in its author a thorough comprehension of what may be called the fundamentals in banking currency and exchange. Its scope is comprehensive, and it seeks to establish foundations so firm that while mild forms of crisis will and must of necessity occur, the degenerating tendency toward panic will be next to impossible. It eliminates almost completely the present injurous influence of government finances, to which I have referred, and without cost to the government or the people, enormously strengthens our public treasury to meet, if called upon, the emergencies of war. It puts the bank into those natural relations under which it can safely and effectively serve the commercial and industrial needs of the country.

The propositions involved in the two measures are radically different. As the only two which have yet appeared, they justly demand studious attention and careful thought from every citizen.